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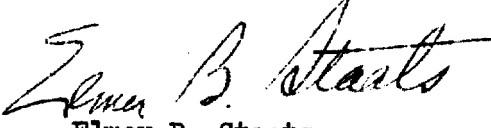
OPERATIONS COORDINATING BOARD
Washington 25, D. C.

September 16, 1954

MEMORANDUM TO THE OPERATIONS COORDINATING BOARD

SUBJECT: Implementation of U.S. Rubber Policy
With Respect to Indonesia

There is attached for consideration by the Board at its meeting of September 22, a program developed in response to NSC Action No. 1173. Also attached is a draft letter to Mr. Lay which will serve to transmit the program as approved by the Board.


Elmer B. Staats
Executive Officer

Attachments:

Implementation of U.S. Rubber Policy
With Respect to Indonesia, 9/16/54

Draft letter to Mr. Lay, Transmittal
of Proposed Implementation of NSC 5417/2,
U.S. Rubber Policy, 9/16/54

OCB File No. 60

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NSC review(s) completed.

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OPERATIONS COORDINATING BOARD
Washington 25, D. C.

September 16, 1954

IMPLEMENTATION OF U.S. RUBBER POLICY WITH RESPECT TO INDONESIA

REFERENCES:

NSC 171/1, Indonesia
NSC 5417/2, U.S. Rubber Policy
NSC Action No. 1173a.b.

SUMMARY

The paper recommends as a course of action to implement NSC action No. 1173, U.S. financial assistance to help rehabilitate Indonesia's smallholder rubber production. It envisages the planting of about 380,000 acres with new, high-yielding rubber trees, the establishment of cooperative processing centers with working capital to buy rubber from smallholders, and the establishment of schools to teach smallholders approved methods of rubber planting, tapping, and processing.

The paper recommends that Indonesia should bear as much of the cost as feasible but recognizes that economic conditions in Indonesia are at present such as to suggest that the U.S. be prepared without commitment or implied promise beyond the period for which funds and authority are actually available to underwrite a substantial portion of the total. All but \$3 - 5 million of the total would be local currency costs. The total cost of the program is estimated at \$60 million over a twelve-year period.

The U.S. share could be financed through surplus agricultural commodities or through commodities other than agricultural surpluses under foreign aid appropriations or under separate legislation. In both cases the rupiahs resulting from the sale of these commodities would be used for the rubber program. The dollar requirements for the program might be in the form of loans.

Basic to these recommendations is the fact that the Indonesian smallholder rubber grower is producing rubber from old, low-yielding trees, and is marketing his rubber through middlemen who have a tight stranglehold over him. Indonesia is facing ruinous competition from more efficient natural rubber producing countries, such as Malaya where an aggressive replanting program is under way, and from synthetic rubber producers. The solution to Indonesia's rubber problem lies in planting new high-yielding trees and in giving the smallholder alternative marketing channels.

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RECOMMENDATIONS

1. The U.S. should indicate to the Indonesian Government that we are prepared to give favorable consideration to an Indonesian request for financial assistance in developing a program to aid its rubber industry along the following lines:

a. The rehabilitation of smallholder rubber production by planting approximately 380,000 acres with new rubber trees.

b. The establishment of cooperative processing centers in the replanted areas with working capital to be used as a revolving fund to finance purchases from smallholders.

c. The establishment of schools where smallholders could be taught approved rubber planting, tapping, and processing. The development of detailed projects would have to be worked out between the two governments concerned.

2. The cost of the program is estimated at about \$60 million over a twelve-year period, with about 60% of the total costs being incurred in the first six years. Indonesia should bear as much of the cost as feasible but economic conditions in Indonesia are at present such as to suggest that the U.S. be prepared without commitment or implied promise beyond the period for which funds and authority are actually available to underwrite a substantial portion of the total. All but \$3 - 5 million of the total would be local currency costs.

3. The United States' share of the total cost could be financed through (1) surplus agricultural commodities, the local currency proceeds of which to be used for the program, and/or (2) commodities other than surplus agricultural products under foreign aid appropriations or under separate legislation with the local currency resulting from the sales of these commodities in Indonesia to be used for the program. The dollar costs of the program might be in the form of a loan from the Export-Import Bank, the IERD, or a regional development fund now under contemplation.

4. The smallholder who receives assistance under this program should be required to repay the Indonesian Government for at least a part of the costs incurred after his new trees become productive. These funds could then be used to continue the program beyond the acreage contemplated in this paper.

BACKGROUND

As pointed out in NSC 5417/2 the country of Southeast Asia facing the major rubber problem is Indonesia. The economic

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well-being of Indonesia presently depends upon the exportation of natural rubber from that country. There is reason to fear, however, that in the very near future Indonesia will lose out to her competitors unless energetic measures are taken immediately to rehabilitate her rubber industry.

Indonesia faces ruinous competition from two directions, from synthetic rubber and from natural rubber produced more efficiently in other countries. Her principal natural rubber competitor, Malaya, is making a determined effort, under the joint leadership of private industry and the government, to lower unit costs by increasing per-acre yields. Similar efforts are being made in Ceylon. In South America and Africa new plantations are being established with high-yielding trees. Her problem has grown so large that it probably can be solved only with outside assistance.

The rehabilitation of Indonesia's rubber industry is quite realistic in terms of the future of natural rubber. At the present time supply and demand are in approximate balance. The International Rubber Study Group concluded in May 1954 that by 1958 world consumption of natural and synthetic rubber will have increased by an estimated 15 percent over 1954 levels. The share which natural rubber will get out of the total will depend upon its ability to compete with synthetic rubber in the large area of usage in which they are interchangeable. The ability to do this will be enhanced by the increased efficiency of the natural rubber industry through replanting with high-yielding species. If natural rubber cannot compete with synthetic there will be an incentive on the part of consuming countries to expand synthetic capacity, which, once done, will gradually doom inefficient natural rubber producers.

DISCUSSION

1. What needs to be done

The Indonesian rubber producing industry is divided arbitrarily into estates and smallholdings. This division is based upon the legal nature of landholding and not, as in Malaya, on size.

Estates are producing areas controlled by aliens or by Indonesians assimilated to the European system of law. Smallholdings are producing areas governed by local customary law (adat) usually, if not always, providing for communal ownership and control. Although size is not the controlling criterion (as it is in Malaya), and there is some overlap, estates tend to be large and smallholdings tend to be small.

The estates -- at least the larger and more progressive ones -- need no outside technical or financial assistance. Their owners

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know what needs to be done and have the wherewithal to do it. But they are reluctant to make large capital outlays for replanting or other improvements unless given firm assurances concerning land tenure, remission of profits, etc.. In this respect their problems are not unique to rubber, and the only way in which United States Government officials can help is to impress upon their Indonesian counterparts as often as they have an opportunity to do so the importance to Indonesia of encouraging private foreign investment. A treaty of friendship, commerce, and navigation between the United States and Indonesia would be helpful.

Among the larger smallholdings there may be some, probably resembling an estate in appearance, which need little or no outside help. At the opposite extreme there most certainly are some smallholdings which are almost hopeless and the immediate rehabilitation of which will be impossible. Others fall between the extremes.

There are an estimated one million families in Indonesia, encompassing perhaps six million persons, who are dependent on smallholder rubber production. The largest concentration of smallholders is in the Palembang area in Sumatra.

The following discussion is based upon conditions observed in the Palembang area which by any standard -- area under cultivation, production, number of landowners, or number of tappers -- accounts for about one quarter of Indonesia's smallholding industry. No smallholding area is likely to be found in worse shape than the Palembang area, some may be much better.

Complete rehabilitation of the smallholding industry in the Palembang area would require action on these fronts: (1) to improve efficiency of production; (2) to improve efficiency of marketing; and (3) to eliminate smuggling and black market operations in rupiahs. There is some overlap between points 2 and 3. To date official efforts by the Indonesian Government have been concentrated almost entirely in those fields. The truth of the matter, however, is that unless Point 1 is solved it is useless to solve the other two, since there will be little rubber to sell or smuggle, and not much market for it on a competitive basis.

The average Indonesian smallholding contains slightly under four acres. A few contain as many as 250 acres, others contain an acre or less.

A typical smallholding in the Palembang area is nothing more nor less than jungle which happens to be composed of rubber trees, of all sizes intermingled, self-sown amongst a tangle of underbrush. The potential annual yield of the average smallholding is estimated by

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the Indonesian Government at less than 400 pounds an acre, contrasted with the yield of 1,200 or more pounds which is obtainable from an efficiently managed estate planted with high-yielding trees.

It would be impracticable to replant the smallholding areas as the first step in a program of rehabilitation. They are too small, too tangled, too uniformly low in yield. Before replanting they must be cleared entirely of existing vegetation; and this is impracticable unless the smallholders themselves are given an alternate source of cash income.

For this reason it is proposed that once it has been decided what acreage ultimately should be re-planted the first step is to open up with new plantings a somewhat smaller number of virgin acres. Fortunately there is ample unoccupied or unused land (at least in the Palembang and Djambi areas in Sumatra and the Pontianak and Bandjarmasin areas in Borneo) to make this approach feasible. Fewer acres would be needed in order to maintain a given output because the trees with which they would be planted would yield three times as much rubber per acre as the trees ultimately to be cut down. The new trees would be high-yielding; set out according to estate practice. In appearance the new groves would resemble sections of an estate. Once the new trees came into bearing the old area would be cleared and replanted in its turn or diverted to other uses. The acreage involved in the program should probably include land reserved for food crops, grazing, and home sites.

The proposed scheme would do three things: (1) Maintain production and smallholder income approximately at present levels during the rehabilitation process; (2) increase production and smallholder incomes in the long run; and (3) put the smallholdings on an efficient basis with high-yielding trees so staggered that no more than half would become over-age at any one time in the future.

2. How to do it

The proposed smallholder program would presumably be carried out under the overall direction of the Kantor Karet Rakjat (People's Rubber Office) which would also act as a central point of coordination for all the other participating agencies. To the maximum extent possible, advantage should be taken of the cooperative movement, the importance of which in Indonesian society is recognized in Article 33 of the Indonesian Constitution. United States nationals should remain in the background as much as possible, giving advice only when requested or to the minimum extent necessary to protect American investment in the project. Opportunities might present themselves, however, for European and American-owned estates to participate in the program, thus indirectly advancing their own cause with the Indonesian Government.

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At the local level the program would focus in smallholder schools, of which one exists in the Palembang area. Smallholders attend this school for forty days during which they are taught approved methods of planting, tapping, and processing. It is suggested that only graduates of a smallholder school be permitted to participate in the proposed replanting program. This suggestion is made for several reasons: (1) to increase the prestige of the schools as nuclei for an agricultural extension service comparable to the county agent system in the United States; (2) to enlist support initially from the most progressive and energetic smallholders (these being the ones most likely to avail themselves of the opportunity for self-advancement offered by the school); and (3) to increase the likelihood that the new planting, and later the replanting, will be carried out correctly. The number of schools in existence should be increased as rapidly as trained staff are available in order to get the planting and replanting program under way without undue delay. The schools could also serve as the headquarters and distribution center for each area involved in the program. The schools might develop into broader vocational training centers to teach tractor operations and repair, electrical wiring, etc.

Participating smallholders would continue to tap their present holdings. Part of their time, however, would be spent on clearing, replanting, and bringing to maturity a new stand of high-yielding rubber trees. For this activity they might be paid by the Indonesian Government.

Once the new plantings were of tapping age (at the end of seven or eight years), the participating smallholders would tap their new trees to the exclusion of the old. The latter might be abandoned or they, in turn, might be destroyed and replanted. The decision as to which course to pursue in a given case would depend on local conditions and on the outlook for natural rubber. In those cases where the old holdings were replanted, the entire program would cover approximately fifteen years.

Each smallholder participating in the program should probably sign an agreement with the Indonesian Government that he will maintain his newly planted land over the period required to bring the new trees to maturity.

3. What would it cost

The total cost of the planting program depends on three factors -- the per-acre cost of the planting, the number of acres to be planted for the first time, and the number of acres to be replanted. All three factors are subject to wide variation.

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The direct cost of clearing land, planting with high-yielding trees, and bringing new plantings to maturity is estimated to range from \$125 to \$275 an acre. The basis for these estimates is given in Appendix 1. The comparable cost in Malaya is \$200. The higher estimate for Indonesia would apply to land infested with alang-alang, the lower estimate to land comparatively free of this grass. From one-half (in the case of the lower estimate) to two-thirds (in the case of the higher) of the cost would be incurred the first year, the remainder over the next six. Cooperatives might be organized in various areas to control the mechanized equipment needed to do a proper soil preparation job.

The biggest imponderable in these estimates, the presence or absence of alang-alang, can only be answered by reference to specific plots of land. It has been assumed that in the interest of speed and efficiency, the initial clearing would be done mechanically with the aid of a tractor hired from the People's Agricultural Department (Djawatan Pertanian Rakjat).

The next biggest imponderable is what figure to include for hand labor used in planting and upkeep. The figure could range from zero (if all the work were done gratis by the smallholder himself and his family) to roughly \$91 if only outside labor were used and if tapping wages were paid. For want of a better figure, an average of \$45.50, midway between these extremes, has been used. It is unlikely that many smallholders would have sufficient vision to contribute their labor for seven years (although they could afford to do so since they still would be tapping their old holdings). On the other hand it is equally unlikely that all the work would have to be done by outsiders or that they could command the full wage of a skilled tapper.

The amount of money available for the program would be the principal determinant of how many acres could be replanted. To replant all the acreage now devoted to smallholder rubber might cost almost one billion dollars. To replant one-third of this area (a program which would maintain the present potential productive capacity) might cost \$160 million assuming the use of land that does not have many planting problems. Either figure would be astronomical for Indonesia itself and demonstrates why outside assistance is essential if more than a fraction of the Indonesian smallholdings are to be rehabilitated.

A different approach to the problem is based not on the needs of Indonesia but on the fact that the U.S. originally suggested a development program as a constructive alternative to an international rubber buffer stock which, it had been assumed, would require a U.S. investment of about \$50 million. A program of approximately \$50 million with selection of land that would represent low-cost planting and with the use of high-yielding stock, could result in the planting of

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about 380,000 acres. This would be equivalent to the replanting of approximately 1,140,000 acres at present yields. Somewhat less than half of the total cost would be needed for initial planting costs; the balance would be needed to bring the trees to maturity in six additional years.

In order to have funds to continue the program beyond the acreage contemplated in this paper and to maximize the smallholder's interest in the program, the Indonesian Government might require the individual participants to repay at least part of the costs of the program after the trees reach tapping age. These payments could be small sums per smallholder over an extended period. As the payments accumulate they could be used as a revolving fund to continue the project.

4. Phasing of replanting operations

For this program to result in the maximum political benefit to the U.S. it will be necessary that as many smallholder areas as possible be made aware of the program through actual replanting operations within the areas.

During the first twelve months of the program it would probably be impractical either to expect to replant all of the acreage under consideration or to start operations in all smallholder areas. Malaya's replanting program had as its first year goal 40,000 acres; even with extensive preparations, only 24,000 acres were replanted the first year.

There would be a fundamental difference, however, between the Malayan program and the contemplated Indonesian program. The former involved cutting down old trees and replanting on the same acreage. The Indonesian program would involve planting new trees in presently uncultivated acreage and not cutting down the old trees until the new acres had reached maturity. Furthermore, in view of the fact that the Indonesian program would be limited to only about 380,000 acres it should be possible to select land free of alang-alang grass or other obstacles to planting.

It is believed that actual planting of approximately 380,000 acres could be accomplished in six years on the basis perhaps of the following schedule:

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(In Acres)

<u>Year</u>	<u>Sumatra</u>		<u>Borneo</u>		<u>Total</u>
	<u>Palembang</u>	<u>Djambi</u>	<u>Pontianak</u>	<u>Bandjarmasin</u>	
1	10,000	-	10,000	-	20,000
2	15,000	10,000	15,000	10,000	50,000
3	20,000	15,000	20,000	15,000	70,000
4	20,000	20,000	20,000	20,000	80,000
5	20,000	20,000	20,000	20,000	80,000
6	20,000	20,000	20,000	20,000	80,000
			TOTAL		380,000

5. Phasing of replanting expenditures

With a six-year period for initial replanting, the total program to bring all trees to maturity would take twelve years. Costs might be phased over this period in the following way:

<u>Year</u>	<u>Initial Replanting Costs</u>	<u>Upkeep</u>	<u>Total Costs</u>
(In million U.S. Dollars)			
1	1.1 (20,000 acres)	--	1.1
2	2.7 (50,000 acres)	0.2	2.9
3	3.7 (70,000 acres)	0.8	4.5
4	4.3 (80,000 acres)	1.7	6.0
5	4.3 (80,000 acres)	2.7	7.0
6	4.3 (80,000 acres)	3.6	7.9
7	--	4.6	4.6
8	--	4.3	4.3
9	--	3.7	3.7
10	--	2.9	2.9
11	--	1.9	1.9
12	--	1.0	1.0
Total	\$20.4	27.4	47.8

These figures do not include administrative costs for the program. There is no basis on which to estimate such costs other than the experience of the Malayan replanting program. In Malaya administrative costs were equal to about 15 percent of the replanting costs. If this percentage were applied to Indonesia, the program would cost an additional \$7.2 million.

6. Complementary steps

A program of planting and replanting, possibly along the lines suggested in previous sections of this paper, is the most

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important single step toward improving the living standard of the Indonesian smallholder. By itself it could go a long way toward improving the competitive position of his rubber. Low unit costs of production would result from the use of high-yielding trees. Approved methods of agronomy such as are followed already on estates would facilitate tapping. Continued attention to replanting as trees became over-age would permit the smallholdings to be self-sustaining.

Improvement in the economic status of the smallholder would be incomplete, however, unless additional measures were taken to loosen the stranglehold which middlemen and loan sharks have on the marketing of smallholder rubber. Furthermore an early start in this direction would tend to increase the returns to the smallholder in the short run and, by thus stimulating confidence in the earning power of rubber, would increase the incentive to replant and to bring the new trees to fruition.

In Malaya a smallholder is free to sell his rubber in the form of latex to any of several competing buyers (the estate companies send out tank trucks for the purpose of collecting latex from smallholders who wish to sell to them), or he may sell it in the form of slabs or blankets to middlemen, or he may process it into sheet in central processing stations owned by cooperatives. The extent to which Indonesians can be given similar freedom to sell latex is limited by lack of roads or by the distance which separate most estates from the principal smallholding areas or by the absence of adequately financed and managed cooperatives.

The solution to Indonesia's smallholder marketing problem lies in the establishment of cooperative processing centers to which the smallholder could bring his latex, get paid for it, the cooperative in turn processing it into sheets and selling it to traders. The cooperatives would in effect be alternative buyers who could compete with the present buyers of smallholder rubber. These cooperatives cannot be too successful in themselves without working capital to be used to buy latex from the smallholder. Upon selling the smoked sheets to traders, a cooperative's funds would be replenished and be available for further purchases from smallholders.

In areas where this is adequate soil or water transportation and where rubber acreage is fairly concentrated it would be possible for the cooperative processing centers to consist of sheeting plants using power driven machinery of low horse power. These plants could process the latex produced on 2500 to 5000 acres. In other areas where transportation is not adequate and where rubber holdings are scattered, the processing center might consist of a small smoke house which would involve no more than a few coagulating pans, a few hand mangles, one or two paid employees, a small building or two, and

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fuel. The smokehouses would service smallholders within walking distance of it. The cost of these processing centres might range from \$2500 for the small smokehouse to \$50,000 for the sheeting plant. A detailed survey of the areas involved would have to be made before deciding what type and what size center should be built in each area.

All of these cooperative centers would require working capital. The amount of working capital needed for each would depend upon the number of smallholders with whom each did business.

It is believed that these centers would require perhaps \$4 million both for construction and equipment as well as for working capital.

The establishment of smallholder schools, referred to above, would also assist the small rubber grower in Indonesia. There is no basis for estimating either the cost or desired number of smallholder schools. Assuming \$50,000 for the cost of building and equipping a school and assuming twenty such schools, another \$1 million would be involved in the program.

Other desirable steps would consist of (a) measures to stabilize the rupiah to reduce shipments of Indonesian rubber for processing in Singapore and to stabilize the Indonesian economy; (b) roadbuilding to make possible tank truck collection of latex and the establishment of large, more efficient processing centers; and (c) a system of rural banking which would give the smallholder an opportunity to hold on to his rubber until he canvassed the market for the best price. No recommendations are made in this paper with regard to these points.

7. Means of financing

The total cost of the whole program might come to approximately \$60 million, broken down as follows:

Replanting	\$ 47.8 million
Administration	7.2
Cooperative Processing Centers	4.0
Smallholder Schools	1.0
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	\$ 60.0

All but \$ 3 - 5 million of the total costs will be local currency costs. The dollars that might be needed would be used for the purchase of machinery, tractors and bulldozers, construction materials, chemicals, etc..

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a. Indonesian Financing

To the maximum extent feasible the costs of the program should be borne by Indonesia because only by shouldering a part of the burden will Indonesia take responsibility to administer the program properly and wisely. The actual share to be borne by Indonesia can only be determined through negotiations between the two governments concerned. It is recognized, however, that the status of the Indonesian economy is such that Indonesia will not be in a position to pay for the entire program and the chances are that Indonesia will not be able to pay for more than a small part of the total costs.

The Indonesian economy is characterized primarily by mounting balance of payments deficits, rapid loss of foreign exchange, budgetary deficits and increased money circulation which is resulting in creeping inflation. While internal production is being maintained and indigenous food supplies are barely adequate, development generally is lagging far behind population growth.

The current account deficit for Indonesia is estimated at \$251 million for 1952 and \$130 million in 1953. The present rate for 1954 is about equivalent to that for 1953. Financing of the deficit has been accomplished largely by drawing down reserves, which dropped from the equivalent of \$592 million in December 1951 to \$239 million in March 1954 and were estimated at approximately \$176 million in June 1954. These holdings are now beneath the minimum percentage required by law for covering the current liabilities of the Central Bank.

For export earnings, Indonesia is dependent primarily on rubber, tin and copra, the prices of which have declined greatly from the Korean boom peaks. Rubber, for instance, fell from approximately \$0.80 a pound to about \$0.19 in the first quarter of 1954, although it has increased somewhat in recent months. The indices of the terms of trade rose from 100 in 1950 to 104 in 1951 and fell to 78 in 1952. It is believed that there was a further decline in 1953.

Foreign exchange-wise, the Indonesian situation is not a dollar problem. On trade account, Indonesia has consistently had a surplus in its dollar area trade. The deficits stem largely from its regional and sterling area trade.

Internally, in spite of balance of payments deficits, the money supply has been increasing (albeit at a declining rate), rising by 31 percent in 1952 and 14 percent in 1953. In the first quarter of 1954 it increased by 2.2 percent. The primary cause of the increase in money supply has been the deficit financing of the government budget,

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achieved by borrowings from the Central Bank. The 1952 deficit was the equivalent of \$463 million; in 1953 it was \$175 million. For 1954 the deficit reportedly will reach \$220 million in spite of Indonesian efforts to limit it to \$90 million.

b. U.S. Financing

Under the recommendations of the NSC, referred to above, the U.S. might be able to pay for that portion of the costs which Indonesia cannot underwrite in the following ways:

1. Under Public Law 480 sales of surplus agricultural commodities might be made to Indonesia for rupiahs and the local currency resulting from such sales could be used to pay for some of the costs of the program. Public Law 480 provides authority for three years.

2. Direct dollar grant assistance might be extended to Indonesia. The dollars in turn would be converted into local currency to the extent necessary.

3. Assistance might be extended in the form of commodities other than surplus agricultural products shipped to Indonesia by the U.S. Government with the commodities then sold for local currency for use in the program.

4. A long-term dollar loan might be extended to Indonesia with conversion to rupiahs.

Of these four possibilities it would appear that the first and third offer the most realistic course of action in view of the dominant need for local currency rather than for dollars and because the program requires financing over a twelve-year period. However, it may be possible to handle dollar costs through loans by the Export-Import Bank, the IBRD, or the regional development fund that is now under consideration, if it should have been organized by the time this program is implemented.

In the first alternative surplus agricultural commodities might be made available for a three year period. The only limitation on the total amount that might be made available under this alternative is the extent to which such surpluses can be shipped to Indonesia within the criteria established by Public Law 480. Of particular importance is Section 101, paragraph (a), which requires the President to "take reasonable precautions to safeguard usual marketings of the United States and to assure that sales under this Act will not unduly disrupt world prices of agricultural commodities"

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In the third alternative shipments of commodities to Indonesia would require, in order to procure the commodities in question, either a dollar allocation out of foreign assistance appropriations or a separate appropriation. The local currency accumulated from the sale of these commodities in Indonesia could be used as needed to finance the program. It might be noted that in 1953 the U.S. had exports of \$104 million to Indonesia. This included grains, \$10.4 million; tobacco, \$8.7 million; dairy products, \$0.6 million; fruits, \$0.1 million; cotton manufactures, \$20.4 million; automobiles, \$10.2 million; railroad equipment, \$6.0 million; electrical machinery, \$5.0 million; steel mill products, \$4.0 million.

8. Negotiating Procedure

The United States cannot force its plan of rehabilitation upon Indonesia. For a number of reasons, of which perhaps the least important is the terminology in which American assistance was offered to natural rubber producers at Colombo, the initiative should come from the Indonesians. The U.S. should in an appropriate manner indicate to the Indonesian Government the U.S. interest in the development of a program to aid its rubber industry.

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It is quite possible that the Indonesians will suggest alternative proposals to the U.S. plan. The problem will then be to work

The point should not be overlooked that this program will not terminate the production of the traditional grades of smallholder rubber in view of the fact that a substantial number of smallholders will not be participating in the program. Even the cooperative processing centers referred to above will probably have to make cheaper grades than No. 1 sheets in order to process all of the rubber produced by the smallholder.

Every opportunity also should be seized, as long as is necessary throughout the operation of any program, to impress upon the Indonesians the importance of providing a proper investment climate for the estates. If possible the estates should be brought into the plan to the extent of offering technical assistance, thus tending to prove to the Indonesians that there is no basic conflict of interest between estates and smallholders.

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Appendix 1

Provisional estimates regarding the cost of a program of new plantings of rubber by smallholders in Indonesia

The attached tables indicate that the estimated minimum cost of establishing and bringing to maturity new plantings to replace every acre of smallholder plantings now in being in Indonesia would be in the vicinity of \$460 million. Around \$60 million or 15 percent, of this amount would go for administrative expenses; \$400 million would be spend on the program proper.

The cost figure of \$400 million is based on an estimate that the cost per acre would amount to \$125. However, if any of the new planting should take place in areas where alang-alang grass is firmly established, additional clearing costs would raise that estimate to \$275 per acre. None of these estimates, incidentally, takes into consideration the cost of the labor which the owner-smallholder and his family would contribute.

Since the new plantings would be high-yielding, it would not be necessary to replant the entire acreage now devoted to smallholder rubber in order to obtain the same amount of rubber now produced. The average "potential" yield of present Indonesian smallholder plantings is about 390 pounds per acre. New, high-yielding stock is capable of producing 1,200 pounds per acre under field conditions with proper care. Hence a program of new planting need only cover around 1.1 million acres of the existing 3.2 million acres to give Indonesia the same potential yield of smallholder rubber she now possesses (i.e. 557,000 long tons a year).

Planting the smaller area, with perhaps an allowance for meeting increased future demand for rubber, would permit maintenance of foreign exchange earnings while releasing labor and land for use in a parallel program of economic diversification. In addition, a program based on the lower figure might avoid extensive use of alang alang land which is so costly to clear.

The following table compares the possible costs of planting programs based respectively on 3.2 million and 1.1 million acres:

Item	<u>3.2 million acres</u>		<u>1.1 million acres</u>	
	<u>High cost</u>	<u>Low Cost</u>	<u>High Cost</u>	<u>Low Cost</u>
	Millions of Dollars			
Cost of clearing and planting	649.6	169.6	223.3	58.3
Cost of bringing to maturity	230.4	230.4	79.2	79.2
Total	880.0	400.0	302.5	137.5
Administrative charges	60.0	60.0	20.0	20.0
Grand total	940.0	460.0	322.5	157.5

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Table 1. Estimated cost of bringing one acre of rubber trees to maturity in Indonesia.

Item	High Cost	Low Cost
1. <u>Clearing, using tractor</u> ^{1/}	\$160.00	\$ 35.00
2. <u>Planting</u>		
200 seedlings or buddings ^{2/}	35.00	10.00
Labor ^{3/}	8.00	3.00
3. <u>Maintenance</u>		
Fertilizer ^{4/}	25.00	25.00
Other materials (including seeds for cover crop and some fencing) ^{5/}	1.50	1.50
Labor ^{6/}	<u>45.50</u>	<u>45.50</u>
4. Total for 7 years	\$275.00	\$125.00

1/ The high cost figure is related to clearing land which is infested with alang-alang; the low cost figure relates to the cost of clearing land free from alang-alang. The inclusion of an operator in both costs has been assumed in the absence of information to the contrary and on the assumption that the average smallholder in Indonesia would not have a working knowledge of the equipment. The farmer may recover some of his expenses by selling brush and felled trees for firewood.

2/ The high cost figure is based on the actual cost of a seedling or budding (13¢); the low cost figure is based on the average price which the Indonesian Government charges the smallholder (5¢). Use of 200 seedlings or buddings per acre is based roughly on the average plantings recommended for smallholders under various planting systems developed by the Peoples Rubber Office (KKR).

3/ Based on an identical allowance used under the Malayan replanting scheme

4/ Estimates on the cost of fertilizer based on Malayan replanting scheme under which a flat charge is made by the government amount to around 3¢ per lb. for fertilizer. Soil conditions in Indonesia, however, are such as to make possible a smaller application of fertilizer than in Malaya.

5/ This is related to Malayan payments under the replanting scheme to very small smallholdings. Probably very little fencing, if any, could be counted on with such a small allowance.

6/ Includes no allowance for labor performed by the owner or his family. The figure is estimated at 1/2 the wages a tapper might command when rubber is at 23¢ per lb. with yield per acre assumed at 250 lbs. per year.

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Table 2. Estimated cost of planting an area in Indonesia equal to that presently under smallholder rubber

(millions of dollars)

Item	High Cost	Low Cost
<u>Cost of clearing and planting:</u>		
(3.2 million acres at \$203 (high cost or \$53 (low cost))	649.6	169.6
<u>Maintenance:</u>		
(3.2 million acres at \$72 for both high cost and low cost)	230.4	230.4
<u>Total 7-year cost:</u>		
(excluding administrative costs)	880.0	400.0
<u>Administrative costs:</u>		
(15 percent of low cost program) ^{1/}	<u>60.0</u>	<u>60.0</u>
Total	940.0	460.0

^{1/} The ratio of 15 percent is based on British expectations with respect to the replanting scheme for Malayan smallholders. The figure for administrative costs was derived in both cases in terms of the low cost figure because administration costs presumably would not be affected by a higher cost of tractor hire and seedlings.

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OPERATIONS COORDINATING BOARD
Washington 25, D. C.

September 16, 1954

MEMORANDUM FOR: Mr. James S. Lay, Jr.
Executive Secretary
National Security Council

SUBJECT : Transmittal of Proposed Implementation
of NSC 5417/2, U.S. Rubber Policy

REFERENCES : NSC 171/1, Indonesia
NSC 5417/2, U.S. Rubber Policy
NSC Action No. 1173a.b.

The President, in approving NSC Action No. 1173 on July 16, 1954, directed the OCB to develop a feasible, integrated program with respect to the rubber problem of Southeast Asia, particularly in Indonesia, and to report to the Council with estimates of the general magnitude of the cost.

Attached hereto is a proposed program, including cost estimates, which has been prepared in response to the directive referred to above. Provision has been made in the proposed program for relating appropriate aspects thereof to the regional economic grouping concept now under consideration. It is anticipated that the proposed program will have a favorable psychological impact on smallholders and Indonesians generally.

The Operations Coordinating Board, in approving this program, is aware that the responsible departments and agencies are concerning themselves with the achievement of broader U.S. policy objectives with respect to Indonesia including:

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- (a) The improvement of Indonesia's foreign exchange position;
- (b) The diversification of the Indonesian economy and the development of small soft goods type industries;
- (c) The strengthening of vocational education and co-operatives in Indonesia;
- (d) The development of expanded student exchange and cultural exchange programs.

The program makes no recommendations with respect to Thailand. It is the view of the Operations Coordinating Board that the United States might also consider making limited sums available, perhaps not exceeding \$1 or \$2 million, to assist Thai rubber production through technical assistance, if requested by Thailand and if investigation reveals a need for such assistance.

Elmer B. Staats
Executive Officer

Attachment:

Implementation of U.S. Rubber Policy With
Respect to Indonesia, 9/16/54

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